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No. 82-435

In the Supreme Court of the United States

OCTOBER TERM, 1982

COMMONWEALTH EDISON COMPANY, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENTS IN OPPOSITION

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QUESTION PRESENTED

Whether the decision of the Interstate Commerce Commission not to include a productivity adjustment in its initial formulation of the Index of Railroad Costs, adopted pursuant to Section 203(a)(a)(2)(B) of the Staggers Rail Act of 1980, 49 U.S.C. (Supp. IV) 10707a(a)(2)(B), was consistent with the statute and a reasonable exercise of discretion.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A-1 to A-36) is reported at 677 F.2d 915. The decision of the Interstate Commerce Commission (Pet. App. C-1 to C-33) adopting its final rule is reported at 364 I.C.C. 841.

JURISDICTION

The judgment of the court of appeals was entered on May 4, 1982. A petition for rehearing was denied on June 15, 1982 (Pet. App. B-1). The petition for a writ of certiorari was filed on September 13, 1982. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. In 1980, in an effort to streamline the administrative process accompanying rate increases for railroads, Congress passed the Staggers Rail Act, Pub. L. No. 96-448, 94

Stat. 1895 (codified in scattered sections of 11, 45, and 49 U.S.C. (Supp. IV)), which modified the authority of the Interstate Commerce Commission to review rate increases. Of particular concern to this case is Section 203(a) of the Act, 49 U.S.C. (Supp. IV) 10707a, which immunized certain rate increases from Commission review in order to allow the railroads to recover fully inflation-caused cost increases.

Section 203(a) provides for a complex set of formulations in order to determine whether a particular rate is subject to any ICC review. Thus, the new section permits regulated railroads[1] to raise their rates without any ICC review, so long as the increased rate does not exceed an "adjusted base rate" for the transportation involved. The statute defines an "adjusted base rate" as the "base rate" for a commodity's movement (generally, the rate in effect on a date specified) multiplied by a cost adjustment factor published quarterly by the Commission, 49 U.S.C. (Supp. IV) 10707a(a)(2)(A). The cost adjustment factor, in turn, is defined in 49 U.S.C. 10707a(a)(2)(B), as:

> a fraction, the numerator of which is the latest published Index of Railroad Costs (which index shall be compiled or verified by the Commission, with appropriate adjustments to reflect the changing composition of railroad costs, including the quality and mix of material and labor), and the denominator of which is the same index for the fourth quarter of 1980, or for the fourth quarter of 1982 or for the fourth quarter of every fifth year thereafter, as appropriate.

In sum, the statute requires the Commission to establish an index of costs and revise it periodically to reflect inflation; that index is then included in the cost adjustment factor

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[1]The Commission only has jurisdiction over rates set by carriers that are not subject to effective competition from other carriers, i.e., market dominant carriers. 49 U.S.C. (Supp. IV) 10701a(a), and 10701a (b)(1).

which in turn establishes the maximum to which the railroad can increase its rates without being subject to any reasonableness inquiry.

2. To implement this new section, the Commission issued a Notice of Proposed Rulemaking in Ex Parte No. 290 (Sub-No. 2), 45 Fed. Reg. 81217 (1980) and proposed to adopt as the Index of Railroad Costs a modified version of the input price index developed and used by the Association of American Railroads (AAR). The AAR index was designed to measure increases in the prices of fuel, materials and labor purchased by railroads.[2]

The Commission's Notice discussed the differences between input price indexes and output cost indexes.[3] An input price index measures inflation's effect on the prices railroads pay for the goods and services they consume to produce transportation service. In contrast, an output cost index measures inflation's effect on the costs per unit of railroad output. The difference is that an output cost index takes into account factors such as productivity, traffic mix, and traffic volume, all of which affect how much it costs a railroad to produce a unit of transportation. The Commission proposed not adjusting the AAR index to reflect productivity.

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[2]Construction of the AAR index begins with selection by purchasing officers from ten representative railroads of a market basket containing 65 items that are representative of the railroad industry's materials purchases. The materials index is then combined with a wage index to produce a final weighted index reflecting the mix of materials and labor in total railroad costs. Periodically, the AAR updates the index to reflect changes in the market basket's composition, and changes in the mix of material and labor.

[3]Because the AAR index measured only 72 percent of rail costs, however, the Commission proposed to use the Bureau of Labor Statistics' Producers Price Index (PPI) to measure the other 28 percent of rail costs until the AAR index becomes all-inclusive. The PPI measures average prices paid to producers of commodities.

In April 1981, the Commission adopted the index proposed in its prior Notice, and explained its decision not to adjust the AAR index to reflect productivity (Pet. App. C-1 to C-33). The Commission found that because Section 203(b) of the Staggers Rail Act of 1980 does not specify whether an input price or output cost index should be used for the railroad cost adjustment factor, the Commission could make that decision as a matter of policy (Pet. App. C-6). The Commission acknowledged that productivity adjustments are theoretically possible, but it also noted that the methodological problems involved in such measures are "grave," and concluded that it would be inappropriate to adjust the AAR index for productivity as long as the railroads are not earning adequate revenues (*ibid.*). In the Commission's view, forcing railroads to give up productivity gains in the face of inadequate revenues would tend to perpetuate an investment climate in which railroads would have difficulty attracting capital (*ibid.*). The Commission also noted that an industry average productivity adjustment might unfairly penalize carriers who, for reasons beyond their control, are unable to achieve the average increase in productivity (*id.* at C-7).

3. The court of appeals affirmed (Pet. App. A-1 to A-36). The court first concluded that the statutory language referring to the Railroad Cost Index was ambiguous and that the history of the statute did not disclose clearly whether Congress intended for the index to be based on inputs or outputs (*id.* at A-13 to A-22). The court then considered the purpose of Section 203 and held that it was designed primarily to allow railroads to recover cost increases. The court also concluded that a secondary goal of the statute is to provide expeditious rate increases (Pet. App. A-25). Finding that an output index would be cumbersome and potentially unreliable, the court held (*ibid.*):

> [W]e cannot conclude that this [cost recovery] purpose mandates adoption of an output index regardless of the accuracy of such an index or the feasibility of designing it so as to allow railroads to obtain rate increases in a timely manner.

The court of appeals then considered whether the Commission acted reasonably in deciding on the basis of the rulemaking proceeding not to adjust the AAR index for productivity changes. Noting the Commission's intention to check periodically its current methodology against other data sources, and the Commission's willingness to consider making a productivity adjustment at some later date (Pet. App. A-27),[4] the court narrowed its concern to "whether the Commission has adequately supported its decision to omit [a productivity] adjustment *at this time*" (*ibid.*; emphasis in original). The court found that the Commission's primary reason for using an input index was that available productivity measures are too unreliable and the consequences of overestimating productivity growth too severe to permit an adjustment based on an assumption of continued productivity growth (Pet. App. A-28). Finding support for this rationale in the record (*id.* at A-28 to A-29), the court held that the Commission's initial decision to risk error on the side of cost recovery was reasonable (*id.* at A-31).[5]

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[4]Two months after the court of appeals issued its decision, the Commission responded to the court's opinion and to requests by shippers and opened a rulemaking proceeding in Ex Parte No. 290 (Sub-No. 4), *Railroad Cost Recovery Procedures—Productivity Adjustment* (Pet. App. E-1 to E-4). The purpose of that proceeding is to determine whether the cost recovery index should be adjusted to reflect productivity.

[5]The court also analyzed and found unpersuasive the Commission's three remaining policy reasons for omitting a productivity adjustment. These additional reasons were (1) that an adjustment would unduly penalize railroads with below average productivity performance (Pet. App. A-32 to A-33); (2) that even under competitive conditions businesses do not pass along productivity increases when their revenues are

ARGUMENT

1. Petitioners contend (Pet. 6-9) that the court of appeals erroneously held that Section 203 does not mandate use of an "output" methodology in its Index of Railroad Costs. Petitioners claim (Pet. 6-7) that since Section 203's purpose is cost recovery and not revenue enhancement, the statute simply precludes an input index that omits an adjustment for productivity increases to reflect more accurately the actual effects of inflation. The court of appeals correctly rejected this contention (Pet. App. A-23, A-25).

The practical objective of Section 203's cost recovery index was to assure that railroad rates actually reflect current costs (Pet. App. A-23). Because [theoretically sound] "output" methodology could in practice leave railroads without full inflation compensation if no reliable and quick way to measure productivity exists, the court properly concluded that the statute did not absolutely require an output index. This holding is consistent with the Staggers Rail Act's findings that railroad revenue inadequacy is attributable in large measure to the inability of railroads in the past to keep their rates even with inflation. See Pub. L. No. 96-448, Section 2, 94 Stat. 1896; H.R. Rep. No. 96-1036, 96th Cong., 2d Sess. 95-96 (1980). Because an inaccurate or time-consuming productivity adjustment could prevent railroads from recovering fully the effects of inflation, the court of appeals correctly interpreted Section 203 as not requiring an "output" index, if immediate use of that methodology would keep the railroads in the unsatisfactory revenue position the Act was adopted to remedy. In light of the ambiguity in the statutory language and the legislative

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inadequate (*id.* at A-33 to A-34); and (3) that an adjustment would undermine incentives for productivity improvement (*id.* at A-34 to A-35).

history, the reasonable decision of the court of appeals that the policy of this complex Act could be furthered by the Commission's "input" index does not warrant review by this Court.

2. Petitioners argue (Pet. 7) that the Commission failed to explain adequately its decision to rely solely on an input index and that the court of appeals therefore was required to affirm the administrative decision on a basis not advanced by the agency. Petitioners' contention ignores the specific finding by the court of appeals (Pet. App. A-28) that

> [t]he crux of the Commission's rationale is that available productivity measures are sufficiently unreliable, and the consequences of overestimating productivity growth are sufficiently grave, that it is inappropriate to adjust the cost index on the assumption of continued productivity growth. The Commission's assessment of the unreliability of productivity measures finds support in the record.

The court of appeals correctly found that although the Commission cited several reasons for its rule the existence of substantial doubt about the reliability of any productivity measures was a significant reason why the Commission decided to adopt an input index.[6] Moreover, the court of appeals examined the record and found support for the

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[6]The Notice of Proposed Rulemaking stated (45 Fed. Reg. 81218 (1980)): "[F]or a number of reasons, we think a productivity adjustment would be impossible at this time, and would not significantly change the index figures. First, * * * there is no acceptable measure of productivity available." In adopting the final rule, the Commission said (364 I.C.C. 841, 846 (1981)): "On further consideration, we now conclude that methodological problems of productivity measurement alone (although grave) do not preclude the development of productivity measures. We nevertheless question the reliability of such measures and as a matter of policy do not believe that their use is justified."

Commission's finding that such measures may not be reliable (Pet. App. A-28 to A-30). Thus, the court confined its review to the agency's articulated rationale in deciding that the Commission's initial formulation of a cost index that relied solely on inputs was reasonable.[7]

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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[7]Petitioners assert (Pet. 9-11) that the discrepancy between actual inflation and the recovery allowed by the Commission's rule will subject shippers to huge and unchallengeable rate increases over the next ten years. This hypothetical argument is baseless. The Commission is now reexamining the productivity issue. See note 4, *supra*, and thus petitioners' concerns are being fully protected in an ongoing administrative proceeding. There is no reason for this Court to intervene on this issue at this time.